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OFFICE OF FINANCIAL AND INSURANCE SERVICES
DEPARTMENT OF LABOR & ECONOMIC GROWTH
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BILL ANALYSIS

BILL NUMBER: Senate Bill 1061 (S-2, As Passed the Senate)
TOPIC: Regulation of Captive Insurance Companies
SPONSOR: Sen. Alan Sanborn
CO-SPONSORS: Sen. Whitmer
COMMITTEE: House Committee on Insurance
Analysis Done: February 13, 2007

POSITION

The Office of Financial and Insurance Services opposes the bill in its current form.

BACKGROUND

A captive insurance company is an insurance company formed by a business owner (or owners) to insure the risks of the operating business. The operating business pays premiums to the captive company and in turn, the captive company insures the risks of the operating business. There are several types of captive insurance companies:

- **Single Parent** – underwrites risk of companies related to the parent company
- **Association of Captive** – a captive that insures the risk of member organizations of an association and the affiliated companies of those members
- **Agency Captive** – captive formed by insurance brokers or agents to allow them to participate in the high-quality risk, which they control
- **Protected Cell Captive** – a captive owned by an insurance company that insures risks of separate participants through the use of protected cells
- **Risk Retention Group (RRG)** – a RRG is a captive insurance company organized for the primary purpose of insuring liability exposures of its group members.

DESCRIPTION OF BILL

SB 1061 defines "captive insurance company" as a pure captive insurance company, association captive insurance company, sponsored captive insurance company, special purpose captive insurance company, or industrial insured captive insurance company authorized under Chapter

46. A branch captive insurance company would have to be a pure captive insurance company with respect to operations in Michigan, unless otherwise permitted by the Commissioner. SB 1061 establishes the following types of captive insurers:

"Pure captive insurance company" would mean a company that insured risks of its parent, affiliated companies, controlled unaffiliated companies, or a combination of those entities.

An "association captive insurance company" would be a company that insured risks of the member organizations of the association and their affiliated companies. "Association" would mean a legal group of individuals, corporations, limited liability companies (LLCs), partnerships, political subdivisions, or groups that had been in continuous existence for at least one year and that owned, controlled, or held, or whose membership organization owned, controlled, or held, all of the outstanding voting securities of an association captive insurance company incorporated as a stock insurer or organized as an LLC; or had complete voting control over an association captive insurance company organized as a mutual insurer.

"Sponsored captive insurance company" would mean a captive insurance company in which the minimum capital and retained earnings required by applicable law were provided by one or more sponsors that insured the risks of separate participants through the contract, and segregated each participant's liability through one or more protected cells (i.e., segregated accounts).

A "special purpose captive insurance company" would be a captive insurer that was authorized under Chapters 46 and 47 and that did not meet the definition of any other type of captive insurance company.

An "industrial insured captive insurance company" would be a company that insured risks of the industrial insureds that comprised the industrial group and their affiliated companies' insureds that comprised the industrial group and their affiliated companies that meet certain other requirements."

"Insured industrial group" would mean either 1) a group of industrial insureds that collectively owned, controlled, or held all of the outstanding voting securities of an industrial insured captive insurer incorporated as a stock insurer or an LLC or had complete voting control over an industrial insured captive insurance company incorporated as a mutual insurer; or 2) a group created under the Federal Product Liability Risk Retention Act as a corporation or other limited liability association taxable as a stock insurance company or a mutual insurer under Chapter 46.

In addition to establishing the types of captive insurers, Chapter 46 sets forth the licensing, regulatory and examination authority necessary for OFIS regulation of captive insurers. In order to conduct business in Michigan, a captive insurer would have to:

- Establish its existence as an entity (i.e., an LLC, corporation etc.)
- Apply for a Limited Certificate of Authority and provide to OFIS extensive information with respect to its proposed operations, including a business plan, plan of operation, biographical information with respect to the principals of the captive, and financial information

- Pay application, examination, and other fees for OFIS regulation
- File of confidential reports to OFIS on at least an annual basis
- This bill would also create the “Captive Insurance Regulatory and Supervision Fund”

Language in Chapter 47 allows for the implementation of the special purpose financial captives (SPFC). The SPFC provides an insurer with an alternative, long term solution for financing its excess regulatory reserves, known as securitization. Typically, an insurer/reinsurer cedes to a SPFC policy liabilities associated with a particular block of business. As compensation for assuming the liabilities, the insurer/reinsurer pays the SPFC a reinsurance premium equal to the economic reserves associated with a particular block of business. Simultaneously, a special purpose issuer, which may be a subsidiary of the insurer/reinsurer, issues debt securities to investors in an amount sufficient to fund the excess statutory reserves over and above the economic reserves. The special purpose issuer then remits all or part of the proceeds from the issuance of the debt securities to the SPFC by purchasing surplus notes or equity of the SPFC, which are deposited into a reinsurance trust to secure the SPFC’s obligations under the reinsurance contract. This chapter’s requirements are:

- The SPFC must obtain a Limited Certificate of Authority from OFIS
- Payment of application, examination, and other fees for OFIS regulation
- Capitalization requirements are set forth
- Allows for various types of entities to be created under the Insurance Code
- Allows for imposition of fees on the SPFC
- Only authorizes the SPFC to insure or reinsure specific risks associated with the parent, affiliated, or an approved nonaffiliated company
- Allows the SPFC to establish protected cells
- Permits SPFC to issue securities
- Provides for SPFC contracts with counterparties
- Provides for rehabilitation, conservation, or liquidation by OFIS of the SPFCs
- Provides for confidentiality of information and documents submitted to OFIS

Language in Chapter 48 allows for the regulation of the protected cell insurance companies under the Insurance Code. This chapter’s requirements are:

- Commissioner approval of plan of operation or amendments for an establishment of a protected cell company
- Protected cell companies must keep assets and liabilities separate from all other company information
- Require a protected cell company to engage in insurance securitization to support risks
- Protect the assets of the protected cell company from any liabilities arising from business of any other company
- Remove requirement to contribute to the guaranty fund

OFIS Concerns

OFIS has not had sufficient time to evaluate whether the proposed fee structure will generate the resources necessary to allow OFIS to properly regulate this program and ensure that the interests of the citizens of the State of Michigan are adequately protected. There needs to be flexibility in setting the fees structure each year to ensure adequate funding for the program and prevent the potential for regulatory subsidization. Previously, a tax had been proposed and with the adoption of the S2 version, OFIS has not had the ability to analyze this proposal and determine if it is feasible in light of the comprehensive regulatory scheme embedded in the bill.

The bill does not provide the requisite licensing, examination and enforcement mechanisms to ensure that the interests of the citizens of Michigan are safeguarded.

The bill does not sufficiently incorporate all the receivership, conservatorship provisions of Chapter 81 of the Michigan Insurance Code, leaving OFIS with grave concerns as to what role and authority it will have if the captive insurer finds itself insolvent. Specifically, the definition of insolvency is much weaker in this bill as compared to Chapter 81 of the Michigan Insurance Code.

Under the Bill, a captive insurer would establish its existence through the DLEG Corporations Division. If the Captive is subject to the Business Corporation Act or the Limited Liability Company Act, there are potential conflicts between these acts and the bill if the Captive becomes insolvent. Currently, insurers are not subject to the Business Corporations Act or the Limited Liability Company Act. If they became insolvent, they are placed into receivership by OFIS. The bill contemplates a potential dual regulatory scheme which may jeopardize OFIS' ability to protect the interests of the citizens of Michigan in the event of insolvency.

The potential for the captive to operate as a separate profit center by writing the risks of third party businesses is of concern. This adds an additional layer of regulatory concern and again, in light of the thin capitalization requirements may not be a practice that promotes the best interests of the citizens of Michigan. For example, could the captive write the risks of entities with which it had no substantial experience or knowledge thus making this riskier?

Pro

Once captive insurance companies can be formed, Michigan will have the flexibility in statute to encourage insurance companies, as well as other large businesses, to domicile in Michigan. The flexibility inherent in the law will make it easier for the large companies to manage their own risk, and as a result, save money over the long run on taxes and reinsurance premiums.

The captive insurance industry is separate from the regular insurance industry. If this legislation is enacted, a new industry will be created in Michigan that will add jobs and revenue to the state.

Con

Captive insurance companies and their affiliates are unique enough in their operation that current Insurance Code laws do not address the needs of the industry. Staff now adequately trained in the financial regulation of regular insurance carriers would presumably not have the appropriate training to effectively regulate the new entities being created under this legislation. OFIS time, staff, and training will be needed to bring adequate regulation to bear on the new entities. New staff would need to be hired and trained, or private contractors would have to be retained in order to effectively regulate captives in Michigan.

FISCAL/ECONOMIC IMPACT

OFIS has identified the following revenue or budgetary implications in the bill as follows:

(a) To the Office of Financial and Insurance Services:

Budgetary: Based on projected staffing, it is estimated OFIS will need an additional 8 FTEs and money for contractual services, creating a need for additional revenue in the amount of approximately, \$960,000 per year.

Revenue:

Comments:

(b) To the Department of Labor & Economic Growth: None

Budgetary:

Revenue:

Comments:

(c) To the State of Michigan:

Budgetary:

Revenue: An estimate has been made that indicates increased tax income for the General Fund, although the specific amount would depend on how many captive insurers will be formed under the new law.

Comments:

(d) To Local Governments within this State: None

Comments:

OTHER STATE DEPARTMENTS

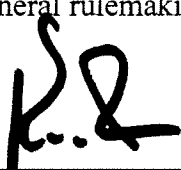
The Attorney General is responsible for reviewing all organizational documents. If established as a limited liability company, that authorization would come through DLEG, Corporations Division.

ANY OTHER PERTINENT INFORMATION

Similar laws are in effect in Vermont and South Carolina. Vermont's captive laws have been in effect for over 25 years. The proposed legislation is based on Vermont's current law.

ADMINISTRATIVE RULES IMPACT

The proposed legislation would amend the Michigan Insurance Code. The OFIS does have general rulemaking authority under the Insurance Code, 1956 PA 218.



Ken Ross
Acting Commissioner



Date